APPENDIX.

REVENUE ACT OF 1936, c. 690, 49 Stat. 1648:
TITLE I—INCOME TAX.

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SUBTITLE C—SUPPLEMENTAL PROVISIONS.

SUPPLEMENT B—COMPUTATION OF NET INCOME.

SEC. 111. DETERMINATION OF AMOUNT OF, AND RECOGNITION OF, GAIN OR LOSS.

See printed Transcript of Record, p. 332.

SEC. 112. RECOGNITION OF GAIN OR LOSS.

See printed Transcript of Record, p. 333.

SEC. 113. ADJUSTED BASIS FOR DETERMINING GAIN OR LOSS.

(a) *Basis (Unadjusted) of Property.*—The basis of property shall be the cost of such property; * * *

SEC. 115. DISTRIBUTIONS BY CORPORATIONS.

See printed Transcript of Record, p. 334.

SEC. 117. CAPITAL GAINS AND LOSSES.

See printed Transcript of Record, p. 336.

SEC. 119. INCOME FROM SOURCES WITHIN UNITED STATES.

For Sections 119(a)(2), 119(a)(6), 119(e) and 119(f), see printed Transcript of Record, pp. 336-338.

Section 119(a)(5), not contained in the printed record, reads as follows:

(a) *Gross Income from Sources in United States.*—The following items of gross income shall be treated as income from sources within the United States:

(5) Sale of Real Property.—Gains, profits, and income from the sale of real property located in the United States.

SUPPLEMENT D—RETURNS AND PAYMENT OF TAX.

SEC. 143. WITHHOLDING OF TAX AT SOURCE.

(b) *Nonresident Aliens.*—All persons, in whatever capacity acting, including lessees or mortgagors of real or personal property, fiduciaries, employers, and all officers and employees of the United States, having the control, receipt, custody, disposal, or payment of interest (except interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having an office or place of business therein), dividends, rent, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable annual or periodical gains, profits, and income (but only to the extent that any of the above items constitutes gross income from sources within the United States), of any nonresident alien individual, or of any partnership not engaged in trade or business within the United States and not having any office or place of business therein and composed in whole or in part of nonresident aliens, shall (except in the cases provided for in subsection (a) of this section and except as otherwise provided in regulations prescribed by the Commissioner under section 215) deduct and withhold from such annual or periodical gains, profits, and income a tax equal to 10 per centum thereof, except that such rate shall be reduced, in the case of a nonresident alien individual a resident of a contiguous country, to such rate (not less than 5 per centum) as may be provided by treaty with such country: *Provided,* That no such deduction or withholding shall be required in the case of dividends paid by a foreign corporation unless (1) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (2) more than 85 per centum of the gross income of such corporation for the three-year period ending with the close of its taxable year pre-

ceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States as determined under the provisions of section 119: *Provided further,* That the Commissioner may authorize such tax to be deducted and withheld from the interest upon any securities the owners of which are not known to the withholding agent. Under regulations prescribed by the Commissioner, with the approval of the Secretary, there may be exempted from such deduction and withholding the compensation for personal services of nonresident alien individuals who enter and leave the United States at frequent intervals.

SUPPLEMENT H—NONRESIDENT ALIEN INDIVIDUALS.

SEC. 211. [As amended by Section 501(a), Revenue Act of 1937, c. 815, 50 Stat. 813.] TAX ON NONRESIDENT ALIEN INDIVIDUALS.

See printed Transcript of Record, p. 338.

SEC. 212. GROSS INCOME.

See printed Transcript of Record, p. 339.

SEC. 217. RETURNS.

See printed Transcript of Record, p. 340.

TREASURY REGULATIONS 94, PROMULGATED UNDER THE REVENUE ACT OF 1936:

Art. 112(i)-1. Reorganization with or transfer of property to a foreign corporation.—

See printed Transcript of Record, p. 340.

Art. 115-5. Distribution in liquidation.—

See printed Transcript of Record, p. 341.

Art. 117-2. Limitations on capital gains and capital losses.—

See printed Transcript of Record, p. 342.

Art. 119-1. Income from sources within the United States.—Nonresident alien individuals, foreign corporations, and citizens of the United States or domestic corporations entitled to the benefits of section 251 are taxable only upon income from sources within the United States.
* * *

The Act divides the income of such taxpayers into three classes:

(1) Income which is derived in full from sources within the United States;

(2) Income which is derived in full from sources without the United States; and

(3) Income which is derived partly from sources within and partly from sources without the United States.

The taxable income from sources within the United States includes that derived in full from sources within the United States and that portion of the income which is derived partly from sources within and partly from sources without the United States which is allocated or apportioned to sources within the United States.

Art. 119-2. Interest.— * * *

Art. 119-3. Dividends.—Gross income from sources within the United States includes dividends, *as defined by section 115:*

(a) From a domestic corporation other than one entitled to the benefits of section 251, and other than a corporation less than 20 percent of the gross income of which is shown to the satisfaction of the Commissioner to have been derived from sources within the United States, as determined under the provisions of section 119, for the 3-year period ending with the close of the taxable year of such corporation preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence); or

* * * * * * * * *

Art. 119-8. Sale of personal property.—Income derived from the purchase and sale of personal property shall be treated as derived entirely from the country in which sold, * * *. The word "sold" includes "exchanged." The "country in which sold" ordinarily means the place where the property is marketed. This article does not apply to income from the sale of personal property produced (in whole or in part) by the taxpayer within and sold without the United States or produced (in whole or in part) by the taxpayer without and sold within the United States. (See article 119-12.)

Art. 143-1. Withholding Tax at Source.—(a) *Withholding in general.*—Withholding of a tax of 10 per cent is required in the case of fixed or determinable annual or periodical income paid to a nonresident alien individual *(even though such individual is engaged in trade or business within the United States or has an office or place of business therein)* or to a nonresident partnership, composed in whole or in part of nonresident alien individuals, except (1) income from sources without the United States, including interest on deposits with persons carrying on the banking business paid to persons not engaged in business in the United States and not having any office or place of business therein, (2) interest upon bonds or other obligations of a corporation containing a tax-free covenant and issued before January 1, 1934 (but see paragraph (b) of this article) (3) dividends paid by a foreign corporation unless (A) such corporation is engaged in trade or business within the United States or has an office or place of business therein, and (B) more than 85 percent of the gross income of such corporation for the 3-year period ending with the close of its taxable year preceding the declaration of such dividends (or for such part of such period as the corporation has been in existence) was derived from sources within the United States, as determined under the provisions of section 119, (4) dividends

distributed by a corporation organized under the China Trade Act, 1922, to a resident of China, and (5) except that such rate of 10 percent shall be reduced, in the case of a resident of a contiguous country, to such rate, not less than 5 percent, as may be provided by treaty with such country. *The tax must be withheld at the source from the gross amount of any distribution made by a corporation, other than a nontaxable distribution payable in stock or stock rights, or a distribution in partial or complete liquidation, without regard to any claim that all or a portion of such distribution is not taxable.* Appropriate adjustments, if any, will be made upon the filing of claims for refund.

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For determining income from sources within the United States, see section 119.

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Art. 143-2. Fixed or Determinable Annual or Periodical Income.—Only fixed or determinable annual or periodical income is subject to withholding. The Act specifically includes in such income, interest, *dividends*, rent, salaries, wages, premiums, annuities, compensations, remunerations and emoluments. But other kinds of income are included, as, for instance, royalties.

Income is fixed when it is to be paid in amounts definitely predetermined. Income is determinable whenever there is a basis of calculation by which the amount to be paid may be ascertained. The income need not be paid annually if it is paid periodically; that is to say, from time to time, whether or not at regular intervals. That the length of time during which the payments are to be made may be increased or diminished in accordance with someone's will or with the happening of an event does not make the payments any the less determinable or periodical. A salesman working by the month for a commission on

sales which is paid or credited monthly receives determinable periodical income. The share of the income of an estate or trust from sources within the United States which is distributable, whether distributed or not, or which has been paid or credited during the taxable year to a nonresident alien beneficiary of such estate or trust constitutes fixed or determinable annual or periodical income within the meaning of section 143(b). *The income derived from the sale in the United States of property, whether real or personal, is not fixed or determinable annual or periodical income.* Such items as taxes, interest on mortgages, or premiums on insurance paid to or for the account of a nonresident alien landlord by a tenant, pursuant to the terms of the lease, constitute fixed or determinable annual or periodical income.

LEGISLATIVE HISTORY OF SECTION 112(i), 1936 ACT.

From Senate Rep. No. 665, 72nd Cong., 1st Sess., 1932 Act, 1939-1 Cum. Bull. (Part 2), p. 515:

SECTION 112(k). *Transfers to Foreign Corporations.*

Property may be transferred to foreign corporations without recognition of gain under the *exchange and* reorganization sections of the existing law. This constitutes a *serious loophole for avoidance* of taxes. Taxpayers having *large unrealized* profits in securities may transfer such securities to corporations organized in countries imposing no tax upon the sale of capital assets. Then, by subsequent sale of these assets in the foreign country, the entire tax upon the capital gain is avoided. *For example,* A, *an American* citizen, owns 100,000 shares of stock in Corporation X, which originally cost him $1,000,000 but now has a market value of $10,000,000. Instead of selling the stock outright A organizes a corporation under the laws of Canada to which he transfers the 100,000 shares of stock in exchange for the entire capital stock of the Cana-

dian company. This transaction is a nontaxable exchange. The Canadian corporation sells the stock of Corporation X for $10,000,000 in cash. The latter transaction is exempt from tax under the Canadian law and is not taxable as United States income under the present law. The Canadian corporation organizes Corporation Y under the laws of the United States and transfers the $10,000,000 cash received upon the sale of Corporation X's stock in exchange for the entire capital stock of Y. The Canadian corporation then distributes the stock of Y to A in connection with a reorganization. By this *series* of transactions, A has had the stock of X converted into cash and now has it in complete control.

While it is probable that the courts will not hold all transactions of this nature to be tax-free exchanges, the committee is convinced that the existing law may afford opportunity for substantial tax avoidance. *To prevent this avoidance* the bill *withdraws* the transaction from the operation of the nonrecognition sections where a *foreign* corporation is a party to the transaction, *unless prior* to the exchange the Commissioner is satisfied that the transaction is not in pursuance of a plan having as one of its principal purposes the avoidance of taxes. It will be noted that under this provision a taxpayer acting in good faith can ascertain prior to the transaction, by submitting his plan to the Commissioner, that it will not be *taxable* if carried out in accordance with the plan. Of course, if the reorganization or the transfer is not carried out in accordance with the plan submitted the Commissioner's approval will not render the transaction tax-free.

This subsection provides for the *full recognition of gain* from any transaction described in any of the designated subsections (b)(3), (4), and (5), (d), (g), and so much of (c) as refers to (b)(3) and (5), involving a *foreign* corporation or the stock *or securities* thereof. That is, the

entire amount of *gain* will be *recognized* upon any transfer of property to or by a foreign corporation, any exchange of stock or securities for stock or securities of a *foreign* corporation or vice versa, or any *distribution* by *or to,* or *of the stock or securities of,* a *foreign* corporation, unless *prior* to the transaction the Commissioner is satisfied that it is not in pursuance of a plan having as one of its principal purposes the avoidance of taxes. For *all other purposes,* including the *non*-recognition of *loss* in any transaction described in the foregoing subsections, the tax status of a foreign corporation is not affected by the new subsection.

Another aspect of this same problem is discussed later in this report in connection with Title VII.

Service of the within and receipt of a copy thereof is hereby admitted this.....day of February, A. D. 1945.

2-16-45—65

SUPREME COURT, U.S.
FILED
AUG 17 1945
CHARLES ELMORE CROPLEY
CLERK

No. 968

In the Supreme Court of the United States

OCTOBER TERM, 1945

WILLIAM G. HAY, PETITIONER,

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE [illegible] CIRCUIT

BRIEF FOR THE [illegible]